



HERRICK K. LIDSTONE, JR.
(720) 493-3195
hklidstone@bflaw.com

MEMORANDUM

TO: Secretary of State’s Working Group on Fraudulent Business Filings

FROM: Herrick K. Lidstone, Jr., member, working group

DATE: November 15, 2022

SUBJECT: Recommendations for consideration by the working group

By his memorandum dated September 30, 2022, Deputy Secretary of State Chris Beall proposed that any member of the Secretary of State’s Working Group on Fraudulent Business Filings (the “Working Group”) should “present any proposed recommendations that the member wishes the Working Group to consider and vote on by December 1, 2022.”

1. The Statutory Report

The Working Group was established by S.B. 22-034 which added C.R.S. § 7-90-315 “to study potential measures to counteract and prevent fraudulent filings in the online business filing system.”¹ The statute went on to require the working group to “submit a report to the general assembly by January 31, 2023, containing potential legislative provisions to counteract and prevent fraudulent filings, as well as the costs and benefits associated with each potential legislative provision.”²

While the report must contain any potential legislative provisions, the earlier provision was broader – to present any “proposed recommendations” to accomplish the purpose of the Working Group. I see the issues before the Working Group as two-fold:

- (i) Protecting businesses from business identify theft (“**hijacked entities**”). This results in an unauthorized person’s taking control over a business entity for such person’s own purposes.³

¹ C.R.S. § 7-90-314(1).

² C.R.S. § 7-90-314(3).

³ Business identity theft (also known as corporate or commercial identity theft) is a type of identity theft. In the case of a business, a criminal will use a business’s identity to establish lines of credit with banks or retailers. With these lines of credit, the identity thieves will buy items that can be exchanged for cash or sold with relative

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- (ii) In other cases, persons use Colorado’s ease of entity formation to form a large number of entities (“**multiplicitous entities**”) in a short period of time for illegal or inappropriate purposes or without appointing registered agents in accordance with the statute. We have seen instances of this with respect to the GName entities where almost 200 entities were formed in a short period of time naming registered agents who did not meet the requirements of C.R.S. § 7-90-701 and apparently emanated from Singapore.

Since the early 1980s, as a result of the extensive revisions in the Colorado statutes (adding limited liability companies and significantly changes the rules for all other forms of entity) as well as adding Article 90 itself, Secretaries of State of both parties have considered their role principally to act as a repository for information, providing clear and easily accessible information on the identity, registered agent, and public information of business organizations. This role has not drawn objections from the legislature or the business community.

This approach is consistent with national models under which the state filing offices have been tasked with combating confusion in the identifying names, documenting continuing existence through periodic reports, and, in the case of some forms of organization – principally corporations – providing some public information on the internal governance rules. The statutes have identified the requirements for filing documents with the Secretary of State,⁴ including:

- Certain specific information about the entity being formed, its principal address, and its registered agent;
- Requiring the identification of the individual causing the document to be filed; and
- Providing that causing a document to be filed constitutes an affirmation or acknowledgement of such person that the document is the act and deed of the person (generally the entity) on whose behalf the document is filed taken in conformity with law and that the document complies with the statute.

The statutes under which these filings are made have never provided that the Secretary of State would conduct investigations of representations in the filed documents. In fact, over the

ease.” The Colorado Secretary of State, the Colorado Attorney General, and the Colorado Bureau of Investigation ID Theft Unit have developed this Business Identity Theft Resource Guide to provide businesses with the information necessary to avoid and reduce the threat of business identity theft and to help those businesses that have already fallen victim to these crimes. But is that sufficient?

<https://www.coloradosos.gov/pubs/business/ProtectYourBusiness/protectYourBusiness.html>

⁴ See, C.R.S. §7-90-301 *et seq.*

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past three decades the ease of formation has encouraged business to form in Colorado.⁵ Nevertheless, as pointed out below, the statutes have provided standards by which the filings could be judged.

In recent years, there has been both state and federal concern with the misuse and abuse of business entities in at least four respects:

- (1) The formation of entities with legal names that are very similar to, but distinguishable on the records from, the entity names of existing or dissolved entities for the purpose of exploiting the goodwill or appropriating the property of the existing or dissolved entity,
- (2) The reinstatement of dissolved entities by persons unrelated to those involved in the dissolved entities, generally for the purposes of engaging in fraudulent transactions,⁶
- (3) The establishment of entities for the sole purpose of concealing the identities of the beneficial owners of the entities to avoid money-laundering and other legal restrictions, and
- (4) The formation of an entity with the designation of a registered agent who has not agreed to perform the duties of a registered agent or that meets the requirements of C.R.S. § 7-90-701.

Each of these issues has been the subject of discussion by the Secretary of State and others, and each should be considered by the committee. Were the Secretary of State charged with investigating each filing before it was made to determine whether any of those circumstances exist, it would impose a significant burden on the Secretary of State and would likely significantly delay any filings – both of which I would find to be unacceptable. The

⁵ See, e.g., Toni Matthews-El, Jane Haskins, Cassie Bottorff, *How To Start An LLC In Colorado (2022 Guide)* <https://www.forbes.com/advisor/business/how-to-set-up-llc-in-colorado/> (“In the past year, Colorado had a record year for new business filings. There are many advantages and considerations when launching a new business in the state.”). See also BoostSuite, *The Best States to Form an LLC* <https://boostsuite.com/llc/best-states/> (“After evaluating all 50 states and the District of Columbia according to their ease of startup, start-up costs, ongoing compliance, and income tax rates, it is clear that the state of Colorado is the best state in which to start an LLC.”) comparing all 50 states in terms of ease of formation, processing time, ongoing compliance, and income tax rates.

⁶ Colorado’s reinstatement statute (C.R.S. §7-90-1001 *et seq.*) allows certain specified persons associated with a Colorado business entity to reinstate a dissolved Colorado entity. Deputy Secretary of State Beall in his memorandum of November 14, 2022, identifies more than 1,000 business entities that were reinstated in the period from November 2021 to November 8, 2022, with very few having the earmarks of a fraudulent reinstatement. It has been a very simple and useful process that provides protections for those who relied upon the dissolution, but one subject to misuse.

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Secretary of State is not a law enforcement agency and should not be in the business of identifying beneficial owners of properly formed entities or the misuse of the entity form. To a large extent, this was the purpose for the adoption of the federal Corporate Transparency Act (31 U.S.C. § 5336) and the federal process of rulemaking.

My comments below are based on the limited jurisdiction of the Secretary of State's office and to attempt to give the Secretary of State some authority to act when it identifies (through third party complaint or otherwise) that filings are not made in accordance with statutory requirements. Nonetheless, it is important to remember that to the extent that properly formed entities are used for criminal or fraudulent purposes, protection of the public from those purposes, identifying and prosecuting the criminal or fraudulent activity is beyond the authority of the Secretary of State.

2. The Secretary of State's Authority

There are statutory requirements with respect to documents filed with the office of Secretary of State. For example:

- C.R.S. § 7-90-301 and the forms themselves require that each filing contain accurate names and addresses, and other information.
- C.R.S. § 7-90-301.5 states that each document filed with the secretary of state "shall constitute the affirmation or acknowledgement of each individual . . . under penalties of perjury," subjecting the filer to possible criminal sanctions where the information is wrong.
- C.R.S. § 7-90-501 requires each reporting entity to file periodic reports that meet certain requirements. Where the entity fails to deliver an accurate report, the Secretary of State can (and does) charge a fee (Section 501(7)), but I believe has administrative authority to take additional action (such as freezing the file).
- C.R.S. § 7-90-601(1) requires that the Secretary ensure that the name of any entity submitted for filing "not contain any term the inclusion of which would violate any statute of this state" and (§ 601(2)) ensure that "each entity name shall be distinguishable on the records of the secretary of state".
- C.R.S. § 7-90-701 requires ("shall maintain") that every domestic and foreign entity "continuously maintain in this state a registered agent" that meets the stated requirements. Section 702 requires prompt amendment when registered agent information changes.

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- C.R.S. § 7-90-1001 *et seq.* provides a procedure for reinstatement of entities after they have been dissolved.

By establishing the standards, the statute gives the Secretary of State authority to act where appropriate. C.R.S. § 7-90-314 already gives the Secretary of State:

- The authority to allow persons to submit a complaint to the Secretary of State's office pointing out issues where their names or addresses are used without their consent,
- The requirement to review the complaint and make a determination whether "the complaint indicates a violation of subsection (1)," and
- Forward the complaint to the attorney general's office as appropriate.

C.R.S. § 7-90-314 only permits the "person that is named in or otherwise affected by the filing of a document" to submit a complaint. The question then becomes whether the authority should be expanded.

3. Recommendations for the Secretary of State's Actions for Consideration

I suggest the following items for discussion by the Working Group. Where I have set forth legislative changes, I am not personally tied to my language or even my format. I also understand that the legislative process will use its wording and formatting where different than I propose. These are thoughts and considerations for discussion and consideration by the group.

a. **Legislative Actions.** I agree with the proposal by Deputy Secretary Beall to consider modifying §7-90-701 to remove any possibility of not understanding the requirements attributable to registered agents:

(1) Every domestic entity for which a constituent filed document is on file in the records of the secretary of state and every foreign entity authorized to transact business or conduct activities in this state shall continuously maintain in this state a registered agent that shall be:

(a) An individual who is eighteen years of age or older whose primary residence or usual place of business is in this state AND WHO IS REGISTERED TO VOTE IN COLORADO AS LISTED IN THE STATEWIDE VOTER

REGISTRATION SYSTEM MAINTAINED BY THE SECRETARY OF STATE;⁷

(b) A domestic entity IN GOOD STANDING AS LISTED ON THE SECRETARY OF STATE'S BUSINESS REGISTRY having a usual place of business in this state; or

(c) A foreign entity authorized to transact business or conduct activities in this state AND IN GOOD STANDING AS LISTED ON THE SECRETARY OF STATE'S BUSINESS REGISTRY having a usual place of business in this state.

(2) An entity IN GOOD STANDING AS LISTED ON THE SECRETARY OF STATE'S BUSINESS REGISTRY having a usual place of business in this state may serve as its own registered agent.

(3) Any document delivered to the secretary of state for filing on behalf of an entity that appoints a person as the registered agent for the entity shall contain a statement that the person has consented to being so appointed.

b. ***Usual Place of Business.*** Much of our discussion has centered around the term "usual place of business" that appears in C.R.S. § 7-90-701 and elsewhere in the Colorado statutes.⁸

In addition to its use in C.R.S. § 7-90-701, the term "usual place of business" is used in the definition of "address" found in several definitions under the CCAA in § 7-90-102:

- i. 7-90-102(50.5) – Principal address
- ii. 7-90-102(56) – Registered agent address.

In no case is the term "usual place of business" defined. Should "usual place of business" for the purpose of 7-90-701 be defined? Should it include a post office

⁷ The Constitutionality of discriminating between those who choose to register and those who don't is way above my pay grade.

⁸ See, for example:

- § 15-5-108(2) referring to the "usual place of business of the corporate trustee . . ."
- § 7-70-108(3) referring to service of process on a trademark registrant
- § 7-71-108(1) referring to recording of a trade name affidavit
- § 37-85-105 referring to an order fixing date of hearing under Article 85 (charge for delivery of water)
- § 23-16-203 referring to the obligation of a non-resident athlete agent to maintain a Colorado registered agent.
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address or UPS store which clearly would not be any person’s “usual place of business” by any definition of the term? I discussed some of these issues in my October 21, 2022 memorandum to the working group that is posted on its website.⁹

The importance of a registered agent who is accessible cannot be overstated. When there is a legal action to be filed against the entity, that is the person who must be served.¹⁰ Clearly that is not possible where the registered agent is really a postal box.

Home addresses would meet the definition of 7-90-102(50.5), but in light of today’s polarized environment, people are unwilling to use home addresses for a public function. People may also be concerned about using their office address. Clearly every business organizer could hire a professional registered agent, but that is money that they may not be willing to spend.

USPS, UPS, and other similar businesses that make post office boxes with a street address available reduce the stress on people about making their address publicly available. But is this appropriate for a registered agent? What does it have to do with a “usual place of business”? I think that this approach may be accepted for the business at issue – but perhaps not for the registered agent. Consider the following changes to § 7-90-701(56):

(56) “Registered agent address” means the street address and, if different, the mailing address of the registered agent’s primary residence in this state or usual place of business in this state if the registered agent is an individual, or of the registered agent’s usual place of business in this state if the registered agent is an entity. FOR THE PURPOSES OF THIS SUBSECTION (56) OF SECTION 7-90-102, THE TERM “USUAL PLACE OF BUSINESS” MEANS A PLACE IN THIS STATE THAT IS OPEN DURING NORMAL BUSINESS HOURS WHERE PERSONS ARE PRESENT AND AUTHORIZED TO PERFORM THE SERVICES OF A REGISTERED AGENT INCLUDING ACCEPTING SERVICE OF PROCESS AND OTHER NOTIFICATIONS FOR THE ENTITY FOR WHICH THE REGISTERED AGENT IS SERVING AS REGISTERED AGENT.

⁹ <https://www.coloradosos.gov/pubs/business/fraudWorkingGroup/2022/20221021HKLMemo.pdf>.

¹⁰ See C.R.S. § 7-90-704(1): “The registered agent of an entity is an agent of the entity authorized to receive service of any process, notice, or demand required or permitted by law to be served on the entity.” Admittedly Section 704(2) provides an alternative where the entity has no registered agent or the registered agent cannot otherwise be found.

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In order to make the new definition crystal clear, consider modifying § 7-90-701 as follows:

7-90-701 (Registered Agent):

(1) Every domestic entity for which a constituent filed document is on file in the records of the secretary of state and every foreign entity authorized to transact business or conduct activities in this state shall continuously maintain in this state a registered agent that shall be:

- (a) An individual who is eighteen years of age or older whose primary residence or usual place of business is in this state;
- (b) A domestic entity having a usual place of business in this state; or
- (c) A foreign entity authorized to transact business or conduct activities in this state that has a usual place of business in this state.

(2) An entity having a usual place of business in this state may serve as its own registered agent.

(3) Any document delivered to the secretary of state for filing on behalf of an entity that appoints a person as the registered agent for the entity shall contain a statement that the person has consented to being so appointed.

(4) THE TERM “USUAL PLACE OF BUSINESS” AS USED HEREIN IS AS DEFINED IN SECTION 7-90-102(56).

The real question to be addressed here is whether this change will drive business from Colorado by being interpreted as requiring entities doing business in Colorado to use a professional registered agent or to have a “usual place of business” which can meet the definitional requirements.

c. ***Fraudulent Filings – C.R.S. § 7-90-314.*** The Secretary of State should consider legislatively broadening the complaint process under § 7-90-314 to include matters (such as registered agents not in compliance with § 7-90-701) even though the persons complaining is not “named in or otherwise affected by” this issue (as required by § 7-90-314(2)). In this case, the Secretary of State should be permitted to make a judgment call whether to make the referral to the attorney general rather than making the referral to the attorney general mandatory as set forth currently in § 7-90-314(3)(a) – requiring that the Secretary of State “shall refer the complaint to the attorney general for review and investigation.”

1. ***Add the following language to the definition of “fraudulent filings” in § 7-90-314(1):***

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(d) FAILING TO INCLUDE ACCURATE AND COMPLETE INFORMATION NECESSARY TO COMPLY WITH THE REQUIREMENTS OF C.R.S. § 7-90-701.

2. Add the following language after § 7-90-314(3) (“Complaint”) as new subsection 7-90-314(3.5):

(3.5) SHOULD THE SECRETARY OF STATE BECOME AWARE OF INFORMATION REGARDING ENTITIES ORGANIZED, INCORPORATED, OR FORMED IN COLORADO WHICH HAS CURRENT FILED DOCUMENTS THAT DO NOT MEET THE REQUIREMENTS OF COLORADO LAW (INCLUDING WITHOUT LIMITATION INCLUDING THE INFORMATION REQUIRED BY § 7-90-701), THE SECRETARY OF STATE MAY, IN THE SECRETARY’S DISCRETION:

(A) CONTACT THE PERSON NAMED IN SUCH RECORD AS REGISTERED AGENT FOR THE ENTITY AND REQUEST THAT THE RECORD BE CORRECTED TO INCLUDE ALL SUCH INFORMATION WITHIN A SPECIFIED PERIOD OF TIME OF NOT LESS THAN THIRTY DAYS FROM THE DATE OF THE SECRETARY OF STATE’S NOTIFICATION; AND

(B) IF SUCH RECORD IS NOT CORRECTED WITHIN SUCH TIME PERIOD, THE SECRETARY OF STATE, USING ELECTRONIC MEANS, MAY (BUT IS NOT REQUIRED TO) REFER THE MATTER TO THE ATTORNEY GENERAL FOR REVIEW AND INVESTIGATION UNDER THE “COLORADO CONSUMER PROTECTION ACT”, ARTICLE 1 OF TITLE 6; AND

(C) AFTER REFERRING THE MATTER TO THE ATTORNEY GENERAL FOR REVIEW AND INVESTIGATION (IF THE SECRETARY OF STATE MAKES SUCH REFERRAL), BLOCK ANY FURTHER FILINGS FOR SUCH ENTITIES PURSUANT TO SECTION 7-90-306.5(B) UNTIL SUCH TIME AS THE ATTORNEY GENERAL’S REVIEW IS COMPLETE FINDING THAT NO FURTHER ACTION IS NECESSARY OR UNTIL THE ENTITY HAS MADE APPLICATION TO THE SECRETARY OF STATE PROVIDING ALL OF THE NECESSARY INFORMATION IN A FILING TO BE PROCESSED BY THE SECRETARY OF STATE AND HAS PAID THE APPROPRIATE FEE TO THE SECRETARY OF STATE.

3. Add the following language in existing subsection 7-90-314(4)(a):

(a) Upon receipt of a complaint referred by the secretary of state in accordance with subsection (3)(a) OR A REFERRAL IN ACCORDANCE WITH SUBSECTION 3.5(B) of this section, the attorney general shall review the complaint or referral and determine whether the complaint OR REFERRAL should be investigated. If the attorney general

determines that the complaint OR REFERRAL should be investigated, the attorney general:

4. *Add a new section 7-90-306.5:*

7-90-306.5. ABILITY OF THE SECRETARY OF STATE TO BLOCK FUTURE FILINGS BY SPECIFIED ENTITIES.

(A) WHERE THE SECRETARY OF STATE HAS IDENTIFIED ENTITIES THAT HAVE BEEN “NON-COMPLIANT” OR “DELINQUENT”¹¹ FOR MORE THAN 12 MONTHS SINCE FIRST BECAME “NON-COMPLIANT” OR HAS BEEN “DISSOLVED” FOR MORE THAN SIX MONTHS (A “DORMANT ENTITY”), THE SECRETARY OF STATE SHALL PROVIDE WRITTEN NOTICE TO THE LAST KNOWN CONTACTS FOR SUCH DORMANT ENTITY AS LISTED IN THE RECORDS OF THE DORMANT ENTITY MAINTAINED BY THE SECRETARY OF STATE WHICH SHALL PROVIDE THAT IF THE DORMANT ENTITY IS NOT BROUGHT UP TO DATE BY A SPECIFIC DATE NOT LESS THAN THIRTY DAYS FOLLOWING THE NOTIFICATION FROM THE SECRETARY OF STATE, THE SECRETARY OF STATE WILL BLOCK ANY FURTHER FILINGS FOR SUCH DORMANT ENTITIES ON THE SECRETARY OF STATE’S BUSINESS REGISTRY UNTIL A PERSON WITH AUTHORITY, UPON PROVIDING EVIDENCE OF SUCH AUTHORITY THAT THE PERSON(S) ARE “OWNERS OR OTHER PERSONS HAVING AUTHORITY UNDER THE ENTITY’S ORGANIC STATUTES AND UNDER ITS CONSTITUENT OPERATING DOCUMENTS” AS REQUIRED BY SECTION 7-90-1002(1)(B) AND PAYS AN APPROPRIATE FILING FEE ESTABLISHED BY THE SECRETARY OF STATE TO DO SO.¹²

(B) WHERE THE SECRETARY OF STATE HAS TAKEN THE ACTIONS SET FORTH IN SECTION 7-90-314.5 AND DESIRES TO BLOCK FUTURE FILINGS OF AN ENTITY AFTER REFERRING THE MATTER TO THE ATTORNEY GENERAL, THE SECRETARY OF STATE SHALL FOLLOW THE PROCEDURE SET FORTH IN SECTION 7-90-306.5(c).

¹¹ Note that C.R.S. § 7-90-905 provides a right for an entity to appeal a declaration of delinquency to the applicable state district court.

¹² In this connection, Deputy Secretary of State Beall’s memorandum of November 14, 2022, is very instructive, finding that the vast majority of reinstatements appear to be proper, but there are some that appear to be improper. Appropriate reinstatements should be allowed and easily obtained, but the statute does impose certain obligations on who may reinstate an entity. If the entity has been dormant for a period of time, it becomes important in my judgment to have some authority before the Secretary of State allows reinstatement. Of course, this would only be the case where the Secretary of State becomes aware of the underlying issues, and there is no obligation that the Secretary go out and investigate.

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- d. ***Non-Legislative Actions.*** Non-legislative actions of greater substance could be taken by the Secretary of State through interpretations published on the Secretary of State’s website, such as the interpretation defining that “each entity name shall be distinguishable on the records of the secretary of state” in §7-90-601(2).¹³

The following actions do not have the substance required for legislation and are more informative:

- Publicize more clearly and more broadly (in the body of the documents that may be filed with the Secretary of State for any entity, such as articles, certificates, or periodic reports) that the filer may (if the filer has the entity authority to do so) password protect the entity’s right to file.
- Publicize more clearly and more broadly (in the body of the documents that may be filed with the Secretary of State for any entity, such as articles or periodic reports) that each individual has the right to obtain email or text notices when documents are filed in the entity’s records.
- Publicize the availability of the remedies under C.R.S. § 7-90-314 when they become available.
- Publicize more clearly and more broadly the business identify theft resources available on the Secretary of State’s website.
- The Secretary of State should consider improving it’s computer capabilities to better identify when there are filings organizing multiplicitous entities by BOTs or other automatic filing services. These are not impermissible under Colorado law. As we have noted in the past, multiplicitous filings tend not to meet certain transparency requirements of Colorado law, such as having a registered agent with a principal place of business in Colorado or being qualified in Colorado as a foreign entity (both requirements under existing Colorado law).

¹³ This interpretation is found at

https://www.coloradosos.gov/pubs/info_center/eLearningCourses/StartingABusinessInColoradoEnglish/page36790.html, although in my experience was not easily locatable. This interpretation was not the product of either rulemaking or statutory amendment.

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I am open to discuss other suggestions by others, but I believe that it remains important for Colorado to maintain its filing system as it is, without significant delays. As noted above, I believe that there are other ways to deal with the issues.